Backgrounder

Consumer and Corporate Affairs Canada   Consommation et Corporations Canada

MODERNIZATION OF CANADA'S PATENT ACT

Fundamental changes to the Patent Act, passed by Parliament in November 1987, are now in effect as of October 1, 1989.

OVERVIEW

The new Act is an important element of Canada's science and technology strategy. Marking the first major overhaul to modernize the Act since 1935, the changes are designed to speed the transfer of technological information to the Canadian business community, thereby encouraging innovation, increasing productivity, and making us more competitive internationally. The amendments also bring Canada into line with the majority of other industrialized nations and provide the means to help Canadians more effectively protect their inventions abroad.

The main changes concern early publication, first to file, absolute novelty, the term of protection, maintenance fees, deferred examination, re-examination of patents, and the Patent Cooperation Treaty.

BENEFITS

Patents give an inventor an exclusive right to produce and market the invention for a specific period of time.* In

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* Patents are occasionally confused with copyright, industrial designs, and trade-marks. Patents are granted for new technologies. Copyright is for literary, artistic, dramatic, or musical works. Industrial designs are for the shape, pattern, or ornamentation applied to an industrially produced object. A trade-mark is a word, symbol, or picture -- or combination of these -- used to distinguish goods or services of one person or organization from those of competitors.

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exchange, the inventor fully discloses his or her invention to the public. An increasingly important benefit of patents is that they help speed the diffusion of new ideas to the public, thereby stimulating further innovation.

The Patent Office is the largest repository in Canada of the latest technological information from around the world. A key function of the Office is to provide such information upon request to Canadian industries, universities and research centres.

Using patent information is essential to keep abreast of technological innovations. The amendments to the Patent Act will stimulate the exploitation and dissemination of this information. They make the Canadian patent system especially useful for small and medium-sized businesses, who traditionally have not had the capability to conduct their own R&D.

By taking advantage of the technological information services of the Patent Office, Canadian businesses will benefit by:

- avoiding the waste of duplicating research by checking the information already available in the Patent Office;
- finding solutions to the technical problems they may be facing;
- identifying alternate technology and new products to produce and market;
- locating improvements to existing technologies; and
- uncovering industry and research trends.

HIGHLIGHTS OF THE AMENDMENTS

Early Publication

Early publication permits Canadians to have access to new technology at an earlier date than under the old Act.

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This feature should prove especially useful for small and medium-sized businesses, who do not have the capacity to conduct their own R&D and therefore, to remain competitive, depend on working out arrangements with inventors to use new technology. Now, a pending application will be available for public inspection 18 months from the earlier of (a) its Canadian filing date or (b) its convention priority date.*

First to File

Under the first-to-file system, when two or more applications for the same invention are pending in the Office at the same time, the patent is granted to the first inventor to file for a patent. Hence it is extremely important to file an application in the Patent Office as soon as possible.

Absolute Novelty

The fundamental requirement for an invention is that it be new. In joining the generally accepted world standard for novelty, Canada will not grant a patent for an invention that has been disclosed before the Canadian filing date or convention priority date. There is one exception to this general rule.

Public disclosure of an invention by the applicant or by a person who obtained knowledge of the invention directly or indirectly from the applicant is allowed if the disclosure is made less than one year ("grace period") before the Canadian filing date.

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* Convention "priority date" means the date accorded under provisions of the Paris Convention for the Protection of Industrial Property or other bilateral treaties between Canada and another country. This gives an applicant up to a year to file in a foreign country and obtain the same filing date as the first filed application.

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Under the first-to-file system, it is risky to disclose an invention before filing a patent application. It's better to play it safe.

Term of Protection

Under the new Patent Act, the maximum life of a Canadian patent is 20 years from the date on which the application is filed in Canada.

Those who infringe a patent will be liable for damages suffered after the patent is granted. In the event of infringement before the patent is granted, they will now have to pay reasonable compensation to the patent holder retroactively to the publication of the patent application in Canada.

Maintenance Fees

Maintenance fees keep patents and patent applications in effect. Canada is one of the last industrialized countries to implement maintenance fees. Their main advantage is to remove inactive patents from the Patent Office files, thus enabling industry to use the technology described in these patents at an earlier date.

Maintenance fees will apply to applications filed after October 1, 1989, and to all patents that are granted after that date. For patent applications filed <u>after</u> October 1, maintenance fees on applications and patents must be paid annually starting on the second anniversary of the filing date in Canada. To maintain rights accorded by a Canadian patent resulting from an application filed in Canada <u>before</u> October 1 and granted <u>after</u> October 1, a patent holder must pay the annual maintenance fee starting on the second anniversary of the issue date of the patent. If the maintenance fees are not paid, applications will be deemed to be abandoned and patents will lapse.

Maintenance fees will encourage applicants and patent holders to re-evaluate the economic value of their applications and patents on a yearly basis. Moreover, this system will ensure that patents which are commercially valuable will bear a greater proportion of the costs than

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those which are allowed to lapse. Finally, under the "small entity" provision, maintenance fees are 50 per cent lower for individual inventors and "small business concerns"* than for larger corporations. This cost break ensures that patent protection is well within reach of small businesses and individuals.

Deferred Examination

Under the old Act, all applications for a patent were automatically examined. Now, under the new Act, an application for a patent is examined only upon submission of an examination request. This request must be made within seven years of the Canadian filing date, accompanied by an examination request fee.

The advantages of deferred examination are twofold. First, the Patent Office can improve service by focusing on those applications which inventors are ready to proceed with. Second, inventors will have up to seven years to assess the marketability of the invention and decide whether to proceed with their applications. If no request for examination has been made within the seven-year period, the technological information contained in the application may be freely used by any interested party.

Re-examination of Patents

This administrative procedure allows for a prompt and low-cost reconsideration of a patent's validity on the basis of "prior-art" documents (i.e., descriptions of the invention that are available to the public). The re-examination is conducted by a Board appointed by the Commissioner of Patents and can be initiated by the patent holder or by a third party at any time during the term of a patent.

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* In addition to meeting several other criteria, defined as businesses with gross annual revenues of $2 million or less.

Patent Cooperation Treaty (PCT)

The new Patent Act allowed Canada to ratify the PCT. The Treaty was ratified on October 2, 1989, and comes into effect in Canada on January 2, 1990. Canadians will be able to file for a patent in as many of the 43 member countries as they choose, with a single application filed in Canada. Prior to PCT, Canadian inventors had to file independently in each country where protection was desired.

PCT is administered by the World Intellectual Property Organization (WIPO) in Geneva. Ratification of PCT provides a standardized international procedure which is shared by our principal trading partners, including the United States, Japan, and most of the European Economic Community.

The Treaty is a one-step patent filing procedure. The eventual granting of patents is under the responsibility and authority of the individual member countries.

Canada has ratified Chapters I and II of the Treaty. Chapter I deals with the international search phase (showing the prior art relevant to the invention being described). Chapter II deals with the international preliminary examination stage which provides a non-binding opinion on patentability.

In addition to deferring administrative costs associated with the filing of multiple applications, the main aim of PCT is to assist inventors, businesses, and patent agents throughout the world by giving them more time and an improved basis for deciding whether and when to start the patent-granting procedure in foreign countries.

Other Amendments

- Given that Canada has moved from a first-to-invent to a first-to-file system, the former Patent Act provision for the filing of a caveat to help establish a date of invention is no longer useful and has therefore been revoked.

° Since Royal Assent in November 1987, the Patent Office has allowed claims to a food or medicine per se except for naturally occurring substances made by a microbiological process. This limitation with respect to microbiology is due to expire on November 19, 1991.

° Also since November 1987, patent holders have no longer been required to mark patented articles.

° Other technical amendments involve clarification of language and intent.

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(Version française disponible)

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QUESTIONS AND ANSWERS: PATENT ACT CHANGES

Protection

1. *Q: Why was the patent system changed from a first-to-invent to a first-to-file system?*

   A: The **first-to-invent** system proved to be extremely cumbersome because the Patent Office had to determine which invention was first. This led to much costly litigation. Under the new **first-to-file** system, when two or more applications for the same invention are pending at the same time the patent is granted to the first applicant who files a patent application on the invention rather than to the applicant who invented it first.

2. *Q: Why is Canada moving to a first-to-file system when the United States, our biggest trading partner, is still on the old first-to-invent system?*

   A: With the exception of the United States and the Philippines, all countries of the world are now on a first-to-file system. The United States has, however, publicly announced its intention to also adopt the first-to-file system. If Canada wants to participate in the world market for technology, it only makes sense for it to operate by world rules for patents.

3. *Q: What protection does an inventor have when his or her application is opened and made available for public inspection before the patent is granted?*

   A: When a patent is granted, the patent holder is in a position to sue infringers for all damages sustained.

From the date an application is opened to the date on which the patent is granted, the patent holder can retroactively sue for reasonable compensation for any infringement occurring during that period.

4. Q: *Who is legally entitled to the patent for an invention in the case where, before the inventor has filed for a patent, someone learns of the invention and files for the patent independently?*

   A: Under the Canadian Patent Act only an inventor is entitled to a patent. Any true inventor who can prove in a court of law that a patent was not in fact granted to the inventor, can have that patent declared invalid.

5. Q: *Why open an application to the public before the inventor has obtained a patent?*

   A: Under the old system the Patent Office published, or made available to the public, the contents of a patent only after it was granted. Now, with early opening of the patent application, the public and in particular small and medium-sized businesses will have access to new technology at a much earlier date. This fulfills one of the primary functions of the patent system, which is to encourage the disclosure of inventions at the earliest date possible.

6. Q: *Can the inventor obtain a patent if an enterprising journalist unrelated to the inventor gets wind of the invention before the inventor has filed an application, and publishes a detailed account in a newspaper, making it public knowledge?*

   A: Yes. Although an invention must be absolutely new to be patentable, the Act provides relief in those instances where an invention has been publicly disclosed by a third party who obtained knowledge of the invention directly or indirectly from the inventor.

7. *Q: Who gets the patent when two inventors file applications on the same invention on the same day?*

   A: Improbable as this scenario is, the Act provides that in this rare occurrence both inventors would get the patent.

Costs and Service Levels

8. *Q: What are maintenance fees, and how do they work?*

   A: Maintenance fees must be paid annually to maintain a patent (or application) in force. These fees allow for a shorter patent term if the invention proves uneconomic or the owner, for any other reason, loses interest in it.

   Maintenance fees defray the administration costs involved in the patent process and are in tune with fees charged by other countries over the life of a patent. In fact, we're very cost-competitive. In addition, smaller companies will pay less than larger corporations.

9. *Q: What is deferred examination?*

   A: Under the old Act every application had to be given a full examination. Deferred examination, on the other hand, is really examination on request only, either by the applicant or by a member of the public who has an interest in the invention. From now on, the Patent Office will not proceed with the examination phase until requested to do so, up to a maximum period of seven years. If at the end of this time a request has not been made, the application will never be examined and will never become a patent. The benefit of this feature is that it allows an applicant to wait while a market or business plan is being developed and then decide if the invention justifies the time and expense of patenting.

10. *Q: Will these changes to the Patent Act increase costs to inventors -- particularly individual inventors -- who are a key group in making Canada more innovative?*

A: The only additional costs consist of the maintenance fees, which inventors must pay for as long as they want to continue protection, up to a maximum of 20 years from the date on which the application is filed in Canada. However, individual inventors and small businesses can still rely on paying half the regular amounts because of the "small entity" provisions of the Act.

Patent Cooperation Treaty

11. *Q: What will be the benefits of the Patent Cooperation Treaty?*

A: After the Treaty comes into effect for Canada on January 2, 1990, Canadian inventors will benefit by being able to:

(a) file for a patent in as many of the 43 member countries as they choose, with a single application filed in Canada;

(b) delay payment of administrative fees to a later date than previously available;

(c) develop improved marketing strategies before proceeding to the final stages of securing patent protection in the foreign countries where protection is desired.

General

12. *Q: Will Free Trade make it even more important for a Canadian inventor to file in the United States?*

A: It's always been imperative to obtain a patent in any country where an inventor wants to protect his or her invention.

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CCAC No. 191 20120 E 89-10

Backgrounder

Consumer and Corporate Affairs Canada
Consommation et Corporations Canada

REAL ESTATE INQUIRY RESOLVED BY ORDER OF PROHIBITION

Historical Perspective

Inquiries into the real estate industry were initiated by the Director of Investigation and Research in 1986 and 1987 following complaints from both consumers and members of the industry. Information gathered by the staff of the Bureau of Competition Policy gave the Director reason to believe that a number of real estate boards might have violated the Competition Act's provisions regarding conspiracy and price maintenance. While these inquiries were ongoing, the Canadian Real Estate Association (CREA) voluntarily approached the Director seeking to resolve the matter without going through the lengthy and costly process of contested prosecutions.

The Director decided that he would attempt to negotiate an Order of Prohibition with the industry through CREA that would address the anti-competitive behaviour which had been uncovered, and which would apply to every board in the country. In addition, the nine (9) boards under investigation were expected to be listed as respondents in the Order.

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CREA, which had never been the object of these inquiries, agreed to become one of the Order's respondents to ensure that its members across Canada would abide by the terms of the Order. CREA owns and manages the Multiple Listing Service (MLS) trade mark and authorizes its members to utilize this trade mark.

The Prohibition Order was negotiated between the Director and CREA as well as the boards under inquiry, and also involved meetings with various other individual boards and provincial associations interested in the Order which were invited to express their views.

CREA member boards discussed the proposed Order at a general meeting on August 12, 1988, and proposed some minor administrative changes to its terms which were acceptable to the Director. On October 15, 1988, CREA member boards voted unanimously to accept the terms of the Order of Prohibition. Later that same month, the Director transmitted the proposed Order to the Attorney General of Canada who then reviewed it and decided to make the application to the Federal Court.

The Order of Prohibition

By removing any impediments to competition, the Order is designed to stimulate and ensure competition in the real

estate industry in Canada and is, therefore, in keeping with the purpose of the Competition Act which is to maintain and encourage competition in Canada.

The Order prohibits CREA, and the nine boards investigated, from committing specified offences under the Competition Act. In particular, the Order prohibits the following:

- fixing or controlling commission rates or fees for the MLS or other listing services;
- restricting the advertisement of rates and fees in any independent publication, or influencing the type of advertising accepted by independent publishers;
- restricting the offering of incentives to home owners e.g. offering a fridge and stove for listing a home with a certain real estate agent or broker; and
- refusing membership in real estate boards or restricting access to the MLS system and to other board services.

An Order of Prohibition issued under section 34(2), formerly section 30(2), of the Competition Act avoids the necessity of a lengthy and costly proceeding and therefore

offers an immediate and less costly method of achieving compliance with the Competition Act. It is an effective resolution in this matter because its provisions apply also to the other 105 boards in CREA not named as respondents but who must agree to comply with the terms of the Order as a condition of their continued membership in CREA. Only by retaining membership in CREA can a board have access to the MLS and other trade marks owned by CREA.

The terms of the Order will encourage more competition in the real estate industry, which may in turn lead to lower commission rates and new and innovative real estate services benefiting the consumer.

Compliance with the Competition Act is ensured through a variety of requirements in the Order:

- the explicit prohibition of certain anti-competitive practices;

- publication of the contents of the Order in local and national newspapers, and once-a-year publication in each of the boards' MLS catalogues;

- a yearly seminar conducted by CREA for its membership outlining the provisions of the Order and explaining the application of the Competition Act to the real estate industry;

- requirements for CREA and its member boards to report membership exclusions and dismissals to the Director for a seven-year period; and

- upon written request of the Director, the respondents must provide by-laws, rules and regulations which he may wish to review to determine if the Order and the Competition Act are being complied with.

The Director and the staff of the Bureau of Competition Policy are available to provide guidance to members of the real estate industry who have questions about the scope and application of the Order as it applies to their particular situation, and they are prepared to address matters raised by the general public concerning the industry's compliance with the Order.

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(Version française disponible)

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Backgrounder

Consumer and
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et Corporations Canada

INFORMATION DOCUMENT ON THE PROPOSED ACQUISITION OF WARDAIR INC. BY PWA CORPORATION

Introduction

The Director of Investigation and Research of the Bureau of Competition Policy today confirmed his decision of April 14, 1989, not to challenge the proposed acquisition of Wardair Inc. by PWA Corporation (PWAC). The Bureau's examination concluded that the likely change in the nature of competition in the domestic airline industry could not be directly attributed at this time to the proposed merger.

The evidence obtained in the Bureau's examination, including the opinion of independent chartered accountants retained by the Bureau, indicates that Wardair Inc. is a "failing firm" within the meaning of the Competition Act. The evidence indicating that Wardair's departure from the market is likely to reduce competition was assessed in light of the fact that Wardair is likely to fail.

Background

On January 19, 1989, PWA Corporation announced its proposed acquisition of Wardair Inc.

The Bureau conducted a comprehensive examination and assessment of the proposed acquisition and its competitive impact. At the outset, the Director clearly informed Wardair that evidence in support of a search for alternative buyers must be provided. This was specifically reiterated to Wardair on March 22, 1989. On March 23, 1989, the Bureau received an application by six Canadian residents (filed

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through the Consumers' Association of Canada) and as a result, initiated a formal inquiry under section 10 of the Competition Act.

Detailed information on the financial condition of Wardair clearly documents the serious financial problems faced by the company. Information was also provided by Wardair on steps taken by management to alleviate problems faced by the company.

Competitive Impact of the Merger

Under the provisions of the Competition Act, the Competition Tribunal may, on application by the Director, make a remedial order in respect of a merger which it finds will, or is likely to, result in a substantial lessening or prevention of competition in a relevant market. Section 93 of the Act lists a number of factors which may be taken into consideration when deciding whether or not a merger will or is likely to prevent or lessen competition substantially. These factors include:

- the extent to which the business was likely to fail;
- any barriers to entry into the relevant market, including regulatory control over entry;
- potential foreign competition;
- effective remaining competition; and
- the removal of an effective and vigorous competitor.

Removal of an effective and vigorous competitor

Information obtained indicates that the acquisition of Wardair by PWAC will result in the removal of an effective and vigorous competitor. Wardair's estimated national market share, for domestic scheduled service is in the order of 5 to 10 percent. For some city pair markets, Wardair's market share is considerably higher than the national figure. This reflects the limited extent of Wardair's service in comparison to PWAC's subsidiary Canadian Airlines International Ltd. (CAIL) and Air Canada (AC).

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Wardair's importance as a rival to CAIL and AC, has been greater than is suggested by its relatively modest market share. Since beginning scheduled services domestically in April 1986, Wardair has attempted to offer a low-priced alternative to the two major carriers. A comparison of fares and schedules demonstrates that price competition was more vigorous in markets where Wardair was present than in markets where only AC and CAIL provide service.

Overall, in markets where it participated, Wardair was often the price leader, offering effective competition to the two established national carriers in all classes of service.

Effective remaining competition

The acquisition of Wardair by PWAC will mean that, with few exceptions, scheduled domestic airline service in Canada will be provided by AC and CAIL or their alliance partners.

In addition, the customers of this duopoly are small in comparison to the suppliers of the service and relatively unorganized. This means that consumers will have little if any countervailing power.

A number of other indications show that there will likely be less competition in the industry subsequent to the merger. The stock market reaction, which led to higher stock prices for both AC and PWAC, suggests that investors expect increased profits for both rivals of Wardair. Moreover, statements by officials of Wardair and PWAC indicate that capacity in the industry is expected to be reduced and the availability of discounted seats will be more restricted than in past years.

In addition, the potential competition from charter carriers such as Air 2000, Odyssey International and Nationair is likely to be limited. These carriers can

provide only a small number of seats to the domestic market in the peak summer months. However, the economies of scope available to carriers with large networks such as AC and CAIL limit the ability of charter operations to discipline the market.

Barriers to entry

The domestic scheduled airline industry exhibits a number of entry barriers which significantly hinder the prospect for entry by new firms in the short to medium term.

Recent economic analysis of the industry indicates that the industry reflects the presence of economies of scope which give scheduled carriers offering a range of fare types cost advantages over scheduled carriers offering one-fare, one-class service, and over charter carriers that can offer only restricted fares with travel conditions on return dates and itinerary changes. In addition, a number of demand side factors give large network airlines such as AC and CAIL significant advantages over carriers offering limited service. These include a preference of the high yield business passenger to choose an airline with a network and frequent flights, a preference for a single carrier created by the brand loyalty developed with frequent flyer programs to use AC or CAIL; and the preference for on-line travel which is facilitated through the commuter alignments developed by network carriers.

Two significant regulatory entry barriers also limit the likelihood of new entry in Canada. The first is the limited ability of Transport Canada to add new carriers at Pearson International Airport. While facilities are available and Transport Canada has a policy that encourages accommodating new entrants, the prime airport space is generally controlled by AC and CAIL. At Pearson International Airport, the most critical public resource at

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the moment is take-off and landing times at peak hours. These are currently limited to 70 per hour. Accommodating new entrants at this juncture will be difficult. Nevertheless, Transport Canada has recently reaffirmed to the Bureau that every effort will be made to do so.

The second-regulatory entry barrier is the restriction of foreign-ownership to a maximum of 25 percent voting interest. This makes it relatively unattractive for American carriers to consider equity interest in Canadian carriers.

Potential foreign competition

In addition to the 25 percent limit on foreign ownership, the Director recognized that there is little likelihood that foreign carriers can enter the domestic scheduled market. Cabotage, or the operation of point-to-point scheduled services within Canada by foreign carriers is currently prohibited by federal law. As such, Canadian origin and destination passengers can only be served by Canadian carriers. This mirrors the situation in the United States where cabotage is also prohibited by law.

Failing firm

In assessing the failing firm factor in mergers that are otherwise considered to be substantially anti-competitive, the Director requires information relating to the following two issues:

1. the extent to which failure is, in fact, likely to occur; and
2. whether there are alternatives to the merger that would be less restrictive of competition.

The financial health of a party to a merger is an important consideration in an evaluation of whether the

transaction is likely to substantially prevent or lessen competition. The rationale is straightforward. A firm that is facing certain and imminent financial failure will cease to exercise any competitive influence in the market after its failure. Therefore, the loss of its influence in the marketplace cannot be attributed to the merger.

A second important implication that arises in this type of merger and that must be assessed, is whether or not the acquiring party will attain a degree of market power that it would not otherwise have acquired in the absence of the merger.

Accordingly, it is necessary to evaluate whether there are other alternatives to the merger that would be likely to have less anti-competitive consequences. There are two classes of alternatives that, in certain circumstances, can give rise to a more competitive environment: first, a merger between the failing firm and a third party (alternate purchaser) and secondly, liquidation of the failing firm.

In some circumstances, the liquidation alternative may facilitate future entry into the market by unknown firms. That is not the case in these circumstances. This is because it is expected that under a liquidation scenario most of the assets of Wardair will be withdrawn from the Canadian market. There now exists considerable excess capacity in the market and Wardair's A310 aircraft are not compatible with the fleets of other airlines in Canada. In the circumstances where a merger will not have a substantially different result than liquidation, the costs associated with a liquidation, including loss of service, job losses, and the loss of the Wardair name, should not be incurred.

A merger between the failing firm and an alternate purchaser may enable that third party to better compete with the original would-be acquiror. However, where, as in this

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case, there are no immediate alternative buyers who would be able to exert a meaningful influence in the market, and where there is little evidence to suggest that liquidation would facilitate future entry, then the change that is likely to occur in the competitive environment cannot at this time be directly attributed to the merger but to the exit of the company from the marketplace.

Based on the evidence and analysis of the information provided by Wardair, it was concluded that Wardair is likely to fail. The prevention of such a failure can only be accomplished by the injection of substantial cash into the company through the sale of delivery slots relating to new aircraft and the mortgaging of existing equity in fixed assets. While there is considerable equity in Wardair at this time, operating losses are draining it at an alarming rate. For the fiscal year ended December 31, 1988, Wardair's operating losses were $110 million. Significant operating losses are continuing to occur.

Moreover, cash flow projections indicate that there will not be sufficient cash available to meet a multi-million dollar interest and principal payment due in the Fall of 1989.

In examining the evidence provided by Wardair, the chartered accounting firm of Peat Marwick, retained by the Bureau, reviewed a number of retrenchment scenarios which possibly could prevent Wardair's failure. These included deferment of the principal payments, loans on existing fixed assets, sale of a minority interest and reversion to chartered carrier status. The scenarios considered were either unattainable or unworkable in present circumstances (Wardair's charter presence has been occupied by new entrants).

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It does not appear that another buyer for Wardair is currently available. Despite the public nature of the proposed acquisition and recent efforts to canvass the market, no other offer has been made to acquire Wardair since the proposed merger was publicly announced in January 1989.

CONCLUSION

Based on the evidence reviewed, the Director has concluded that the acquisition of Wardair by PWAC will not likely substantially lessen competition within the meaning of the Competition Act. This conclusion is largely based on evidence that Wardair is a failing business and that there are no alternatives to the merger that would result in a more competitive environment. In this particular case, the significance of the failing firm factor outweighs the negative assessment of the other factors under the Act.

Although the proposed merger will not be the subject of a challenge by the Director at this time, the actual effects of the transaction will be monitored by the Bureau over the three-year period provided by the Act. In this manner, the Director reserves his right to take any future action under the Act that may be warranted.

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Backgrounder

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PROPOSED MERGER OF MOLSON/CARLING O'KEEFE

Introduction

The proposed merger of the Canadian-based brewing operations of The Molson Companies Limited and Elders IXL Limited, the parent company of Carling O'Keefe Breweries of Canada Limited, will be allowed to proceed with no challenge at this time by the Director of Investigation and Research of the Bureau of Competition Policy. The Director, following an extensive examination of information provided to the Bureau by the parties, industry participants in Canada and the United States, provincial regulators and federal officials, concluded that the competitive impact of the merger was of potential competition concern in the provinces of Alberta and Quebec. Under present market conditions, the merger is not likely to raise concerns under the Competition Act in any other area of Canada.

The Transaction

On January 18, 1989, Molson and Elders announced their intention to merge their North American brewing operations into a new company to be called Molson Breweries. Molson Breweries will be owned equally by the parties. The merger will involve the integration and rationalization of the parties' production, distribution, administration, marketing and sales operations in Canada. The parties will also consolidate their sales and distribution operations in the United States in order to facilitate expanded exports of Molson Breweries to that country.

The Merger Review Process

The test under the merger provisions of the Competition Act is whether a transaction is or is likely to prevent or lessen competition substantially. The Act provides that the

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determination of a substantial lessening of Competition cannot solely be based on quantitative factors such as market share and industry concentration. The Act provides that other qualitative factors may also be taken into account in determining the competitive implications of a merger. These factors include:

- any barriers to entry into a relevant market;
- the potential for foreign competition;
- the existence of substitute products;
- whether there is a failing firm;
- the removal of a vigorous and effective competitor;
- the extent to which effective competition remains in the market;
- the nature and extent of change and innovation in a relevant market; and
- any other factor relevant to competition, for example, in this case, the impact of regulation on competition.

The Act also provides for an efficiency gains exception where the efficiencies flowing from the merger are greater than, and offset, the anti-competitive effects of the merger.

If the Director concludes that a merger gives rise to a substantial lessening of competition, the Act provides him with certain remedies. One course available to the Director is that he may challenge the merger before the Competition Tribunal. Should the Tribunal find a substantial lessening or prevention of competition, it may order remedial action to alleviate the competition concerns, including dissolving the merger or ordering the disposal of assets or shares. Another alternative for the Director is to proceed to the Tribunal on a consent order basis with the acquiring party. The Tribunal is then empowered to either approve or reject the consent order application or, with the agreement of the parties, vary all or part of the order. The Director may also accept undertakings from the parties in lieu of proceeding to the Tribunal. Re-structuring of the merger before closing is another alternative. The Director may

also decide to monitor the actual effects of the transaction in the three-year period provided by the legislation in order to determine whether the transaction gives rise to a substantial prevention or lessening of competition.

Present State of the Canadian Brewing Industry

The Canadian brewing industry is extensively regulated, on a provincial and territorial basis. The authorities in various jurisdictions exercise significant but varying degrees of control over the advertising, distribution, retailing, pricing and promotion of beer. The effect of this regulation has been to prohibit the interprovincial distribution of beer throughout most of Canada, and to require Canadian brewers to operate breweries in virtually every province in which they market their product. Consequently, the Canadian market for beer is divided into 12 distinct regional markets in which the nature and extent of price and non-price competition varies considerably.

The segmented nature of the industry is largely responsible for the fact that Canadian brewers operate breweries which are generally smaller and less efficient than the breweries operated in the United States by their American counterparts. As a result, American brewers generally have significant cost advantages in respect of beer which they sell in a number of provinces.

Developments in the Canadian Brewing Industry

The brewing industry in Canada is currently undergoing unique and rapid changes. The tariff and non-tariff barriers to interprovincial and international trade in beer have begun to decline in a number of jurisdictions. Recent proceedings under GATT have given rise to increasing pressure for further reduction or removal of these barriers. In this environment, a number of provinces recently have liberalized their policies so as to give imported beer, particularly from the United States, greater access to their markets. As a result, low-priced beer imported from the United States has become a significant competitive presence in several provinces, including

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British Columbia, Alberta and Ontario. These low-priced imports have contributed to the development of significant price discount segments in British Columbia and Alberta.

Competitive Impact of Merger

Prince Edward Island, Nova Scotia and New Brunswick

Based on the Bureau's examination, the Director is satisfied that the merger will have little impact on competition in Prince Edward Island, Nova Scotia and New Brunswick. Neither party to the merger operates brewing facilities in these provinces. Rather, Molson and Carling are regarded as out-of-province producers, and sell their products subject to higher markups than are imposed in respect of the products of in-province producers such as Labatt's and Moosehead. Partially as a result, the combined sales of the parties to the merger account for less than two percent of the sales in these provinces.

Newfoundland, Manitoba and Saskatchewan

In Newfoundland, Manitoba and Saskatchewan, legislation grants to the provincial liquor authorities exclusive control over the manner in which beer is imported, distributed, marketed and sold. There is effective regulation regarding pricing in each of these markets which, at present, restricts or eliminates price competition among the major domestic brewing companies. Although the promotional activities of the brewers are controlled by regulation in each of these provinces, it is clear that the brewers compete actively in respect of the marketing of their products in such non-price areas as advertising, introduction of new brands, packaging innovations and product quality. The Bureau, in assessing the competitive impact of the merger in these provinces, considered the manner in which the merger would affect existing or future competition in these areas.

In Newfoundland and Manitoba, Labatt's accounts for more than half of the provincial sales and will continue to be the market leader after the merger. Labatt's will also continue to be a significant and effective competitor in

Saskatchewan. The Saskatchewan government has recently announced its intention to allow widespread distribution of low-priced U.S. beer in the province. It is likely that this beer will become an increasing competitive presence in Saskatchewan, given its success in British Columbia and Alberta.

In addition, the consumption patterns in each of these provinces indicate that the markets are mature and that the demand for beer is either constant or declining. This factor, combined with the effective regulation of price, caused the Director to conclude that it would be difficult for the merged entity to exercise market power in any of these three provinces.

The Director concluded, based on the Bureau's examination, that under present market conditions, the merger is not likely to prevent or lessen competition substantially in these three provinces.

<u>Ontario</u>

Ontario, the largest market in Canada for the sale of beer, has one of the most extensive regulatory regimes in the country. Provincial liquor authorities have exclusive control over the distribution, importation and sale of beer. Although regulation in Ontario effectively eliminates price competition among the major domestic brewing companies, they still compete in respect of non-price dimensions such as promotion and brand introduction. In assessing the impact of the merger on competition in Ontario, the Bureau closely examined the manner in which existing or future competition in these areas would be affected.

In its assessment, the Bureau also recognized that the market share of Carling had declined in recent years, particularly following the loss of the Carlsberg brand to

Labatt's after Carling was acquired by Elders. Labatt's is at present the market leader and a very effective competitor throughout this province. There are also several regional and micro brewers in Ontario which provide additional competition. Furthermore, there have been recent developments of significance affecting competition in the Ontario market. Specifically, lower priced beer imported from the United States has recently captured a significant portion of the Ontario market in a very short period.

Given the extent of regulation, the loss of market position by Carling, the very significant position of Labatt's, the presence of other players and the increasing role of lower priced U.S. imports, the Director concluded that under present market conditions, the merger is not likely to prevent or lessen competition substantially in Ontario.

Yukon and Northwest Territories

Neither Molson nor Carling has production facilities in the Yukon or the Northwest Territories. All beer sold in these markets is acquired from British Columbia and Alberta by the liquor authorities which control distribution, promotion, retailing and pricing in these jurisdictions. Given the degree of control exercised by these authorities, the market strength of Labatt's, the limited presence of Carling in both of these markets and the availability of low-priced U.S. beer, the Director concluded that the merger is not likely to prevent or lessen competition substantially in either the Yukon or the Northwest Territories.

British Columbia

The Director reached a similar conclusion in respect of British Columbia, where price competition is less regulated than in most provinces. Labatt's will have a market share in British Columbia almost equal to that of Molson Breweries following the merger, and is an effective and vigorous competitor throughout the province. Furthermore, Pacific Western Brewery is a significant regional brewer and competitor in British Columbia. Also, low-priced beer imported

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from the United States has established an effective competitive presence in British Columbia and has contributed to the development of a large price discount segment representing approximately one-third of the beer sales in the province. That segment appears to constrain price increases throughout the market in British Columbia with the result that the price of a variety of beer sold in the regular segment is currently lower than it was in 1986.

Alberta

In Alberta, based on the Bureau's examination, the Director was concerned that the merged entity would account for more than half of the province's beer sales and would have a market share approximately twice the size of Labatt's, its next largest competitor. However, it is apparent that, like British Columbia, Alberta has benefited from the presence of a strong regional brewer, Drummond Brewing Company, and has seen the development of a price discount segment largely as a result of the entry and growth of low-priced U.S. beer. The constraining influence of this discount segment in Alberta is similar to that of the corresponding market segment in British Columbia. In addition, the Bureau's examination indicated that increased import penetration is likely to contribute to maintaining competition in this market. Accordingly, the Director's current expectation is that if present trends continue, the merger is not likely to prevent or lessen competition substantially in that province.

Quebec

As a result of the Bureau's examination, Quebec is the market of greatest potential concern to the Director. That market is characterized by three roughly equal competitors in terms of sales. The merged entity will have an initial market share in Quebec of approximately 60 percent. While there are several micro-brewers in Quebec, there are no regional brewers currently in the province that are capable of providing additional competition. Also, import penetration is minimal in Quebec. All sales of domestic beer for off-premise consumption are made through the thousands of local retail grocery and convenience outlets

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which are licensed for this purpose. For this reason, access to an established distribution system which services these stores is essential to new entrants in Quebec. The only established province-wide systems for distributing beer to these retail outlets which will exist after the merger will be those owned or operated by Molson Breweries and Labatt's. Furthermore, at present, provincial regulations prohibit the sale in these stores of beer brewed outside the province, including low-priced beer imported from the United States. Primarily for these reasons, imported beer currently constitutes less than one percent of the Quebec market. Carling has been more of an effective competitive presence in Quebec than in any other market, and has the single largest selling brand in the province. Following the merger, Labatt's would be the only remaining competitor in Quebec of any size. In light of these factors, the merger raises concerns at this time as to its potential effect on competition in Quebec.

The Bureau's examination revealed, however, that Labatt's has enjoyed consistent increases in market share in Quebec during the last several years. This growth appears to be attributable to, among other things, the strength of Labatt's in the lager segment of the market and the fact that the preference of consumers in Quebec is shifting from ale to lager. Similar trends in tastes have been observed throughout the rest of Canada and internationally. Carling, which is particularly strong in the ale segment of the market, has suffered from corresponding declines in market share during the last few years.

Furthermore, during the merger review process, the parties represented that there will continue to be increasing pressure to remove the existing provincial and international barriers to trade. The parties anticipate that just as the regulatory regimes and policies which control the distribution of beer in a number of other provinces have changed recently, similar changes are likely to occur in Quebec. They believe that the existing restrictions which prohibit the distribution of out-of-province beer in retail grocery and convenience

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stores in Quebec, including low-priced beer imported from the United States, may be reduced or eliminated.

The parties have informed the Director that they intend to provide access to the Molson Breweries' province-wide distribution system in Quebec for Canadian produced beer (except for Labatt's which has its own well-established system) on a fee-for-service and not for profit basis. The fees charged will enable the parties to recover the costs associated with distributing the products of third parties. Access will be provided for a minimum of three years following the closing of the transaction. The parties have informed the Director that the system will be available immediately for micro-brewers in Quebec and any new entrants in that province, and will be available to out-of-province Canadian and foreign brewers in respect of beer produced by them in Canada, in the event that appropriate regulatory change occurs.

The Director has advised the parties that in view of the rapidly evolving nature of the industry, and the present expectation of the parties that changes will occur to the regulatory regime in Quebec, his current intention is to monitor developments in Quebec during the three year period provided for under the Competition Act. In the event that the changes in Quebec referred to above do not, in fact, occur, and a conclusion is reached that the merger substantially lessens competition, the Director will not hesitate to seek a remedial order from the Tribunal.

Efficiencies

The parties anticipate that the transaction will give rise to substantial gains in efficiencies pertaining to the production, distribution and marketing of beer, particularly in the province of Quebec. They have represented that the great majority of these gains could not be achieved in the absence of the merger. The Bureau's examination indicates that co-packing arrangements and independent rationalization of production facilities either appear to be impractical or of questionable long-term value. The parties intend to achieve these efficiency gains in the near future, given

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their view that the increasing pressure to remove existing barriers to trade will result in increased import penetration in Canada. The parties have stated that the merged entity will be better able to compete domestically and internationally, and anticipate that the merger will expand export opportunities for Molson Breweries, particularly in the United States. The Bureau will monitor closely the activities of Molson Breweries to determine the extent to which these gains in efficiency have been achieved.

Conclusion

The Director, having carefully analyzed the competitive impact of the merger in the various provinces and territories of Canada, has decided not to challenge the merger at this time. Rather, the Bureau will monitor the effects of the merger on competition in the beer industry in Canada, and particularly in the provinces of Alberta and Quebec. The Bureau will be assisted in this regard by a comprehensive monitoring program which has been arranged with the parties pertaining to, among other things, pricing, market shares, marketing initiatives, efficiency gains, export activities, concentration, new entrants, deregulation and distribution in Quebec. The Director will pay particular attention to the changes that may occur in markets such as Quebec in determining whether the merger in fact gives rise to a substantial lessening of competition within the three year period provided for under the Act.

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Backgrounder

Consumer and Corporate Affairs Canada
Consommation et Corporations Canada

IMPERIAL OIL LIMITED/TEXACO CANADA INC.

Introduction

On June 29, 1989, the Director of Investigation and Research of the Bureau of Competition Policy, filed an application with the Competition Tribunal seeking a consent order in the Imperial Oil - Texaco Canada merger. If granted, the order would require Imperial to divest specific assets throughout Canada and would ensure supplies of gasoline to independent marketers in Ontario and Quebec.

The evidence obtained in the Bureau's examination of this transaction indicates that, without the remedies sought in the consent order, Imperial's acquisition of Texaco is, in the Director's view, likely to prevent or lessen competition substantially in the downstream sector of the Canadian petroleum industry. The consent order application seeks to ensure that there is not likely to be any prevention or lessening of competition substantially within this sector of the industry.

This backgrounder covers the following topics, namely: a description of the transaction; the merger review process; a brief overview of the Canadian petroleum industry; a summary of the Director's competition concerns in each region of Canada; the proposed consent order resolution and its projected impact on competition in each region.

The transaction

On January 20, 1989, Imperial Oil Ltd. agreed to purchase all of the shares owned by Texaco Inc. and its subsidiaries in Texaco Canada Inc. Texaco Inc. owned 78 percent of the outstanding shares of Texaco Canada Inc.

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Imperial Oil subsequently acquired all of the remaining Texaco Canada shares for a total purchase price of $4.96 billion, Canadian funds.

Imperial Oil has assets of $9.7 billion while Texaco Canada has assets of $4.1 billion. Both firms are fully integrated, operating at all levels of the petroleum industry. Through the merger, Imperial will acquire all of Texaco's downstream interests including the refineries at Dartmouth, Nova Scotia, and Nanticoke, Ontario; 21 storage and distribution terminals; 942 company-owned retail gasoline outlets; the rights to supply 707 independent dealers who sell under the Texaco brand; and Texaco's pipeline interests. In addition, there are 374 low-volume, primarily rural outlets, who sell under the Texaco brand and who are supplied indirectly by Texaco Canada, through independent wholesale distributors.

On January 20, 1989, Imperial Oil gave the Director unconditional undertakings to divest itself of any assets necessary to alleviate any concerns under the Competition Act in the downstream sector. Imperial also agreed to hold separate and apart the downstream operations of Texaco pending the completion of the Director's examination. Imperial further agreed that the divestiture of any assets may be the subject of an application for a consent order by the Director to the Competition Tribunal.

In a public statement made on February 24, 1989, the Director said that there were a number of competition concerns in the downstream sector of the petroleum industry. He also restated his intention to put any divestiture package before the Competition Tribunal for a hearing on a consent order basis, given the broad public impact of the transaction.

Investment Canada approved the transaction on February 24, 1989, after taking into consideration Imperial's undertakings to the Director. In making his announcement, the Minister responsible for Investment Canada stated that his decision did not, in any way, affect the application of the Competition Act.

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The merger review process

The test under the merger provisions of the Competition Act is whether a transaction is or is likely to prevent or lessen competition substantially. The Act provides that the determination of substantial lessening cannot solely be based on quantitative factors such as market share and industry concentration. The Act requires that other qualitative factors must also be taken into account in determining the competitive implications of a merger. These factors include:

- any barriers to entry into a relevant market;
- the potential for foreign competition;
- the existence of substitute products;
- whether there is a failing firm;
- the removal of a vigorous and effective competitor;
- the extent to which effective competition remains in the market.

The Act also provides for an efficiency gains exception where the efficiencies flowing from the merger are greater than, and offset, the anti-competitive effects of the merger.

If the Director has competition concerns with a merger, the Act provides him with certain remedies. One course available to the Director is that he may challenge the merger before the Competition Tribunal. Should the Tribunal find a substantial lessening or prevention of competition, it may order remedial action to alleviate the competition concerns, including dissolving the merger or ordering the disposal of assets or shares. Another alternative for the Director is to proceed to the Tribunal on a consent order basis with the acquiring party. The Tribunal is then empowered to either approve or reject the consent order application or, with the agreement of the parties, vary all or part of the order. The Director may also accept undertakings from the parties in lieu of proceeding to the Tribunal, or decide to monitor the effects of the transaction in the three-year period provided by the legislation. Re-structuring of the merger before closing is another alternative.

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After notification by Imperial Oil, the Bureau began a comprehensive examination and assessment of the Imperial Oil-Texaco transaction and its competitive impact. This examination was carried out by the Bureau's professional staff who were assisted by independent industry consultants, professional economists, and legal counsel. In addition, the Bureau met with and collected information from refiners, independent petroleum marketers, and other industry members. The Bureau also consulted provincial governments and various associations interested in the merger.

Overview of the Canadian petroleum industry

The likely impact of the merger on competition was examined in both the upstream and downstream sectors of the industry in three relevant market areas: Atlantic Canada, Ontario-Quebec and Western Canada.

Upstream sector

The upstream sector of the Canadian petroleum industry encompasses the exploration, production and transportation of crude oil and other hydrocarbons.

Based on the Bureau's analysis, the Director concluded that there is not likely to be a substantial lessening of competition in the upstream sector of the petroleum industry as a result of the Imperial-Texaco merger. The Director had no significant concerns with this sector, for the following reasons:

- although Imperial will be the largest producer of conventional crude oil, with 16 percent of the market, the upstream sector is unconcentrated with more than 200 large and small producers active in Western Canada;
- since deregulation in 1985, Canadian crude oil prices have been strongly influenced by international market forces;
- post-merger, Imperial will account for 6.9 percent of natural gas production;

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. crude oil and product pipelines are regulated either by the National Energy Board or provincial governments.

Moreover, any likely effect on competition has been mitigated by Imperial's undertaking to Investment Canada to offer for sale some $550 million worth of upstream assets.

The Director's conclusions were fully supported by independent expert consultants.

Downstream sector

The downstream sector of the industry encompasses the refining, distribution, and marketing of refined petroleum products. This sector is characterized by four large fully integrated refiner/marketers which market coast-to-coast (Imperial Oil, Petro-Canada, Shell, Texaco), eight regional refiner/marketers (Suncor, Chevron, Husky, Consumer's Co-op, Irving, Ultramar, Turbo, Parkland), one regional refiner (Newfoundland Processing), and numerous non-integrated firms often referred to as independent petroleum marketers or "independents."

The 13 refiner/marketers operate 26 gasoline producing refineries across Canada.

Independents sell gasoline and/or heating oil in competition with the refiner/marketers. They obtain their supplies from domestic refiner/marketers and foreign sources. They range from comparatively large firms such as Pioneer Petroleums (Ontario), Mohawk Oil (Alberta-Saskatchewan), Sergaz (Quebec), and Atlantic Co-Op (Atlantic) to single outlet entrepreneurs across Canada.

Imports have taken on considerable importance since deregulation of the petroleum industry in June 1985. Although the volume of imports is relatively small at this time, it is on the increase and has had an important role to play in maintaining competition in retail gasoline markets in Ontario, Quebec and British Columbia. Imported gasoline represents an important source of supply for independents.

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Competition concerns

The acquisition of Texaco by Imperial will reduce the number of national integrated refiner/marketers to three and will increase concentration in each region of Canada. The Bureau's examination indicates that competition in the downstream sector is likely to be substantially lessened or prevented as a result of:

- eliminating a major refiner/marketer in the Atlantic Canada region;
- eliminating a significant supply alternative to non-integrated gasoline marketers in Quebec and Ontario;
- reducing the availability of terminal facilities for the storage and distribution of refined petroleum producers across Canada;
- eliminating a large and effective competitor from the branded sector of retail gasoline markets across Canada; and
- an increase in the opportunity for inter-dependent market behaviour among refiner/marketers.

The Bureau's examination focussed on the supply and distribution of motor gasoline throughout Canada (a product for which no viable substitutes currently exist) and heating oil in Atlantic Canada. Elsewhere in Canada heating oil faces strong competition from electricity and natural gas. Aviation fuel and lubricants face strong competition from sources other than Imperial Oil and Texaco.

ATLANTIC CANADA

Existing market situation

There are four refiners operating in the Atlantic region: Irving, Newfoundland Processing, Imperial Oil and Texaco. Texaco's refinery is the smallest in Atlantic Canada. Petro-Canada, Shell and Ultramar market petroleum products in the region through reciprocal supply agreements with the refiners.

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Only Texaco Canada and Imperial Oil supply gasoline and heating oil to independent marketers. Irving, which has a very large presence in most markets, particularly in New Brunswick, does not supply independents. Newfoundland Processing is prohibited by restrictive covenants from selling to the other Canadian provinces.

In the Atlantic region, unlike other regions of Canada, independents form a small part of the market. As a result, they are unable to import marine cargos of refined products or to credibly threaten to do so. Since refiner/marketers control all marine access to imports at the wholesale level, there are no significant imports of gasoline by independents into the Atlantic region.

Another important factor influencing the existing market situation is that entry into gasoline marketing and pricing is largely regulated by the provincial governments of Nova Scotia and Prince Edward Island and there is limited independent presence in these markets.

Finally, because natural gas is not available, the Atlantic region depends on heating oil more so than any other part of Canada.

Competition concerns

On completion of the Bureau's examination, the Director concluded that the merger would remove Texaco as a vigorous and effective competitor in the marketing of gasoline in Atlantic Canada.

The industry is highly concentrated and is subject to high entry barriers. Imperial Oil would become the only refiner located in the Maritimes available as a source of supply for independents in the marketing of petroleum products. Moreover, with the exception of heavy fuel oil, imports are not an important source of supply. Independents also do not own terminals sufficient to handle imports of gasoline. For these reasons the Director has concluded that the merger would likely prevent or lessen competition for refined petroleum products.

Consent order resolution

The economic viability of any refinery is determined by its access to terminal facilities and marketing channels. This is particularly important in the case of small refineries such as that operated by Texaco in Nova Scotia. Because these segments of the industry are so inter-connected, the proposed order requires that Imperial Oil divest all of the following assets in the Atlantic region:

- Texaco's Eastern Passage refinery in Dartmouth, Nova Scotia, which includes the refinery, marine terminal, and related assets. Ultramar's supply agreement at the refinery, which accounts for one-quarter of the output, is also included;
- four storage and distribution terminals located at Saint John (New Brunswick), Chatham/Newcastle (New Brunswick), Charlottetown (Prince Edward Island) and Long Ponds (Newfoundland);
- 197 retail service stations located within the four Atlantic provinces: 95 in Nova Scotia, 75 in New Brunswick, 17 in Prince Edward Island, and 10 in Newfoundland; and
- heating oil assets; commercial/industrial contracts and customer lists.

To the extent reasonable and possible, the Director would prefer that the assets be sold to one purchaser who would likely ensure the continued operation of the refinery as an ongoing concern and supply the domestic market. The Director would retain his rights to approve the purchaser of these assets.

Projected impact

The proposed consent order is designed to maintain the existence of a viable and effective competitor in the Atlantic region by requiring the sale of the Texaco refinery, distribution and marketing network to a third party. In addition, the proposal allows for the opportunity that an independent or other new entrant may enter the

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Atlantic market on a large scale. Texaco's terminal facilities at Dartmouth may permit an independent to compete by also importing lower-priced products from off-shore.

ONTARIO-QUEBEC

Existing market situation

Bureau staff, economic and industry experts have concluded that Ontario and Quebec are effectively one market when analysing the competitive effects of this merger on the supply of refined petroleum products. The two provinces are linked through inter-provincial movements of petroleum products on the Trans-Northern Pipeline which joins Southern Ontario and the Ottawa Valley to Montreal; by marine cargo movements on the St. Lawrence Seaway; by road transport; and by the existence of long-term reciprocal supply agreements between Ontario and Quebec refiners.

There are six refiners in the Ontario-Quebec market operating nine refineries. Petro-Canada, Shell and Ultramar have refineries in Quebec. Ontario refiners include Imperial, Texaco, Shell, Petro-Canada and Suncor. Imperial has a refinery in Sarnia, Ontario while Texaco has a refinery in Nanticoke, Ontario. Neither Texaco nor Imperial Oil have a refinery in the province of Quebec.

Both Imperial Oil and Texaco are significant suppliers of gasoline to independents in Ontario. Texaco is a significant supplier to Quebec independents through its reciprocal supply agreement with Petro-Canada's refinery in Montreal.

Currently, gasoline imports from the United States and offshore account for 3 percent of Ontario's total gasoline supply and 12 percent of Quebec's gasoline supply. Total imports of gasoline account for 10 percent of supplies to Ontario independents and 19 percent of supplies to Quebec independents. In recent years, the threat of increased imports has significantly constrained domestic refiner/marketers' pricing at the wholesale and retail level.

Unlike Atlantic Canada, there is a significant and increasing presence of independent gasoline marketers who are supplied by and compete with the refiner/marketers at the retail level.

Competition concerns

Over the past five years, Texaco has increased its gasoline market share in many major urban markets in Canada, including centres in Quebec and Ontario. The merger removes a vigorous and effective competitor in retail gasoline markets in both provinces. Furthermore, the merger significantly raises concentration at the refining, distribution and marketing levels in the Ontario/Quebec region. Post-merger Imperial Oil would control approximately 30 percent of the refining capacity in Ontario and Quebec. Entry barriers into refining are high with no new refinery expected to be constructed in the region over the next decade. Imperial Oil would also increase its concentration in certain local terminal markets.

Having regard to the change in concentration, the height of entry barriers, the limited volume of gasoline imports, lack of substitutes and the removal of Texaco as an effective competitor to Imperial Oil, the Director concluded that the merger would likely lessen competition substantially in the supply of gasoline to independent marketers.

In 1986, the Restrictive Trade Practices Commission completed its comprehensive five-year inquiry into the state of competition in the Canadian petroleum industry. Its report was issued in June of that year. Part of this report comments on the potential for vertically-integrated refiner/marketers to take advantage of their "market power" in the refining sector in their dealings with independents. As the Commission stated:

> "Refiners enjoy a market power in supply matters that is unavoidable if Canada is to obtain the benefits of economies of scale in refining. This power is enlarged by the vertical integration into marketing that refiners say is necessary to reduce the investment risk of a refinery." (RTPC, p. 245.)

The Commission was particularly concerned that the exercise of this market power could inhibit the entry or expansion of the independent sector. To mitigate these concerns, the Commission proposed a solution in which the refiners would make the capacity of their scarce capital resources available to the independents. It called its solution the "duty to supply" on the premise that someone possessing a high degree of market power who controls access to essential facilities has an obligation to supply unless there is a legitimate business reason for not doing so.

The Commission elaborated on the duty to supply solution at some length in its report:

> "In the Commission's view the preferred focus of public policy in this critical area of concern over supply is to seek to avoid unreasonable anti-competitive effects resulting from the way or the terms upon which the owners of scarce facilities, notably refineries and large terminals, make their capacity available to others. If the market power and vertical integration are to be left in place, in order to facilitate possible economies, care must be taken to ensure that the power is not misused.
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> "In the Commission's view it is therefore important that the scope of the duty to supply on the part of someone possessing a high degree of market power be defined as precisely as possible, and that a mechanism exists by which the principles can be applied in a fair but timely way." (RTPC, pp. 448-449.)
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> ...
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> "The unavoidably high concentration in petroleum refining, together with pervasive vertical integration and dual distribution, makes it very important to take all reasonable steps to maximize the assurance of supply to unintegrated marketers." (RTPC, p. 467.)
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> ...
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> "The Commission's rejection of the more costly and disruptive structural remedies urged upon it in these proceedings followed from its conviction that effective assurance of supply to efficient

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> independents and to potential entrants would be sufficient. Keeping the import option as free and open as possible is part of the answer, but by itself is not enough." (RTPC, p. 453.)

In its examination of the Ontario-Quebec region, the Bureau took into account the conclusions of the Restrictive Trade Practices Commission in its comprehensive report published in June 1986 on the state of competition in the Canada petroleum industry. The Bureau recognizes the role independents play in providing vigorous and effective competition in local gasoline markets and is concerned that as a result of the merger, they could be denied adequate access to competitively priced gasoline supplies in this region. While the import option may prove to be an effective discipline on the pricing policies of refiner/marketers, some independents are apprehensive about relying on foreign sources of supply to successfully operate their businesses. The RTPC noted that import competition can only be expected to work imperfectly to restrain the refiners' control over gasoline supplies. The Bureau notes in this regard that subsequent events, particularly deregulation and the specific provisions of the Free Trade Agreement, may mitigate this concern.

Post-merger Imperial will significantly increase its retail gasoline market share in various large and small urban centres in these provinces. Without divestitures, Imperial would control about 27 percent of total retail outlets in Ontario and 21 percent of total retail outlets in Quebec. Barriers to entry at this level of the industry, such as local regulations and the unavailability of prime sites in some communities, limit expansion by independent marketers.

Proposed resolution

Since independent marketers represent a growing share of the retail market, Imperial Oil has agreed to assure supply of gasoline to independent resellers in Ontario and Quebec from its Sarnia and Nanticoke refineries for at least seven years and at the option of the customer for as long as ten years. Quebec independents are included in the proposed order through Imperial's supply exchange agreement with

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Petro-Canada's refinery in Montreal. Under the proposed order, the term of supply contracts may vary from one to five years at the customer's option. (Imperial Oil may, of course, supply independents for any additional period it and the customer contract for, apart from the supply obligation under the terms of the proposed order.)

The base volume of guaranteed supply to independent marketers is 1.5 billion litres, which represents the combined volumes sold by Texaco and Imperial Oil to Ontario and Quebec independents in 1988. The order also allows for a growth factor based on market growth as well as a pro-rata sharing of any additional output associated with the efficiencies resulting from combining the operations of the Nanticoke and Sarnia refineries.

In the first three years from the date of the order, the Director may apply to the Tribunal to seek any remedy under the merger or other provisions of the Competition Act should the supply obligation under the order prove insufficient to offset the effects of the merger as a result of a material change in circumstances. In years four to seven, the Director is limited to applying to the Tribunal for a variation in the terms of the duty to supply conditions.

In addition, Imperial Oil would divest all of the following assets:

- six storage and distribution terminals located in these provinces: four in Ontario and two in Quebec; and
- 136 retail service stations located in Ontario and 77 retail service stations located in Quebec.

The Bureau's examination indicated that there are factual distinctions between the Ontario and Quebec retail gasoline markets. Post-merger, without divestitures, Imperial would have a higher provincial market share in Ontario (27 percent) than Quebec (21 percent). Moreover, there are many more smaller communities in Ontario than Quebec where the merger leads to a significant increase in concentration. Also, there are more service stations per

capita in Quebec than Ontario. For example, Greater Montreal has about twice as many service stations as Metropolitan Toronto. These and other factors led the Bureau to conclude that there would be more effective competition remaining in Quebec gasoline markets than in Ontario following the merger. Accordingly, more service station divestitures are required in Ontario having regard to the provisions of the legislation.

In determining the gasoline outlets to be divested, the Bureau applied a consistent and systematic approach for Ontario, Quebec and Western Canada, taking particular account of the competitiveness of independents in each local market. In all Canadian cities where Imperial and Texaco compete, and where Imperial's post-merger market share is greater than 30 percent, Imperial is required to divest down to a maximum level of 30 percent if the independents occupy a market share of at least 20 percent. However, where the independents' market share is less and having regard to local entry and other conditions, Imperial Oil is required to divest down to a maximum level of 25 percent in other urban markets. These criteria are fully explained in a schedule appended to the proposed consent order.

As an example, following the divestitures Imperial Oil's retail gasoline market share will fall from 28 percent in Metropolitan Toronto to 25 percent; from 26 percent in Greater Montreal to 25 percent; and from 29 percent in Edmonton to 26 percent.

For very small communities, where pre-merger there are three stations or less, Imperial Oil will be allowed to retain one; if there are four to seven stations, no more than two will be Imperial Oil; and where there are eight or more, no more than one-third will be Imperial.

To the extent reasonable and possible, the Director prefers that the terminals and retail outlets be sold or leased to independent petroleum marketers to facilitate their expansion in wholesale and retail markets. The Director retains his right to approve the purchasers of these assets.

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Projected impact

The proposed consent order ensures that Imperial Oil, the largest refiner in Ontario/Quebec, must continue to make supply available to independent marketers in these provinces for a minimum period of seven years and a maximum period of ten years. This will ensure the maintenance of a viable independent presence in gasoline markets in these provinces. Prior to the merger, Ontario and Quebec independents had no assurance that their contracts would be renewed in the event that supply conditions tighten. They are also entitled to a share of increased gasoline production resulting from increased efficiencies by combining the operations of the Sarnia and Nanticoke refineries.

The order also creates the opportunity for independents to acquire six terminal facilities, some of which are well located marine terminals along the St. Lawrence River and Seaway and Great Lakes. This will allow for the transfer of strategic assets from the refiner/marketers to non-refiners and simultaneously strengthen the import option as a restraint on the market power of domestic refiners.

Finally, independent marketers will have an opportunity to acquire 213 service station sites in the most highly concentrated retail gasoline markets in Ontario and Quebec. This will allow the independents to strengthen their position in these areas.

WESTERN CANADA

Existing market situation

Eight refiners operate in the region, Imperial being the largest with about one-third of refining capacity. The other refiners are Petro-Canada, Federated Co-Op, Husky, Shell, Chevron, Turbo and Parkland. Texaco has no refinery in Western Canada. Federated Co-Op, Turbo, and Parkland are not fully-integrated oil companies.

There is considerable excess refining capacity in Western Canada and this has led to a growing independent presence.

Gasoline imports are not available on the Prairies and provide only a limited option in British Columbia given there is only one independently owned terminal. In B.C., gasoline imports account for eight percent of supplies to independents.

Imperial would have a large presence in three local terminal markets.

Post-merger Imperial would significantly increase its retail gasoline market share in various large and small urban centres in this region. In addition, the merger results in the loss of a vigorous and effective major competitor to Imperial Oil in Western Canada.

Competition concerns

As Texaco Canada does not have a refinery in this region, the merger does not change the integrated industry structure. Therefore, no competition issues are raised in the refining sector. Because of increased concentration and duplication in specific terminal and retail gasoline markets in Western Canada as a result of the merger, and the loss of an effective national competitor, the Bureau's examination concluded that a substantial lessening of competition was likely in these particular markets.

Consent order resolution

In Western Canada, Imperial would divest all of the following assets:

- three storage and distribution terminals located in Alberta and British Columbia; and
- 133 retail service stations located within the four Western provinces: 34 in Manitoba, 32 in Saskatchewan, 47 in Alberta, and 20 in British Columbia.

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The retail divestitures flow from the systematic approach discussed above.

To the extent reasonable and possible, the Director prefers that terminals and retail outlets be sold to independent petroleum marketers to facilitate their expansion in wholesale and retail markets. The Director retains his right to approve the purchasers of these assets.

Projected impact

The proposed consent order makes available three terminal facilities to independents, one of which is a marine terminal. This allows for the transfer of these strategic assets from the refiners to non-refiners in order to enlarge the latter's presence in the downstream sector of the petroleum market.

Independents will have the opportunity to acquire 133 service station sites in the most highly concentrated retail gasoline markets in Western Canada, thereby strengthening the position of non-refiners in these areas.

Divestiture procedure

All divestitures related to sale or lease required by the proposed order are governed by the procedures set forth in the order, and the sale of facilities shall be completed within 12 months from the date of the order. The time can be extended subject to the Director's approval.

If the divestitures contemplated by the order are not completed within the 12-month period, unless extended, Imperial Oil shall transfer the authority to dispose of such assets to a trustee, the appointment of whom is to be approved by the Director. The assets must then be disposed of by the trustee at the most favourable price, terms and conditions available, subject to the Director's approval.

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<u>Summary of the proposed consent order</u>

A. Imperial will be required to divest:

- the Texaco Eastern passage refinery and marine terminal in Dartmouth, Nova Scotia, as well as related assets and contracts;
- 13 additional storage and distribution terminal facilities located throughout Canada;
- 543 retail service stations located throughout Canada.

B. In addition, Imperial Oil will assure supply of gasoline to independents in Ontario and Quebec for a minimum of seven years and a maximum of 10 years.

C. The Director may apply to the Tribunal in the first three years of the order to either vary the terms of the duty to supply or to seek any other remedy under the merger provisions of the Act if such variation is inadequate; in the following four years, the Director may seek a variation in the terms of the duty to supply.

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Reference: Linda R. Bergeron
(819) 953-5303

(Version française disponible)

CCAC No. 189 10250 E 89-06

SCHEDULE 1

Imperial Oil assets prior to merger

- 5 refineries:

Dartmouth, Nova Scotia	(82,300 b/cd)
Sarnia, Ontario	(123,500 b/cd)
Edmonton, Alberta	(164,900 b/cd)
Ioco, British Columbia	(42,800 b/cd)
Norman Wells, NWT	(3,800 b/cd)

- 32 primary terminals:

  8 in Atlantic
  6 in Quebec
  7 in Ontario
  4 in Prairies
  7 in Pacific

- Investments in product pipelines:

Quebec South Shore Products Pipeline	100.0%
Sarnia Products Pipeline	100.0%
Winnipeg Pipeline	100.0%
Alberta Products Pipeline	35.0%

- 3,118 retail outlets
  - 976 company owned
  - 2142 independent dealer owned

Texaco Canada assets prior to merger

. 2 refineries:

Eastern Passage, Nova Scotia	(20,000 b/cd)
Nanticoke, Ontario	(106,000 b/cd)

. 21 primary terminals:

5 in Atlantic
3 in Quebec
10 in Ontario
1 in Prairies
2 in Pacific

. Investments in product pipelines:

Trans-Northern Pipelines	33.3%
Alberta Products Pipeline	20.0%

. 2,023 retail outlets

- 942 company owned
- 707 independent dealer owned
- 374 wholesale-marketer sites

Note: refinery capacity is measured in barrels of crude oil processed per calendar day (b/cd).

SCHEDULE 2

TEXACO TERMINALS

TO BE DIVESTED	TO BE RETAINED
Atlantic	
Charlottetown, P.E.I.	
Chatham, New Brunswick	
Dartmouth, Nova Scotia	
Saint John, New Brunswick	
St. John's, Newfoundland	
Quebec	
Baie Comeau (Imperial Terminal)	Chicoutimi
Rimouski	
Ontario	
Ottawa	Belleville
Sault Ste. Marie	Hamilton
Sudbury	Kingston
Thunder Bay	Nanticoke
	Prescott
	Toronto
Alberta	
Calgary	
British Columbia	
Victoria	
Prince George	

SCHEDULE 3

IMPERIAL/TEXACO RETAIL OUTLET DIVESTITURE

BY PROVINCE

	TOTAL
NEWFOUNDLAND	10
NOVA SCOTIA	95
PRINCE EDWARD ISLAND	17
NEW BRUNSWICK	75
TOTAL ATLANTIC CANADA	197
QUEBEC	77
ONTARIO	136
MANITOBA	34
SASKATCHEWAN	32
ALBERTA	47
BRITISH COLUMBIA	20
	346
TOTAL ACROSS CANADA	**543**

SCHEDULE 4

List of Communities for Service Station Divestiture

A. Atlantic Provinces:

As 197 retail service stations out of the 225 Texaco Canada stations in these provinces are to be divested, this will affect almost every community in which Texaco Canada currently operates.

B. Other Provinces:

(Population greater than 50 thousand*)

	COMMUNITY
QUEBEC	Montreal
	Laval
	Quebec City
	Sherbrooke
	Ste-Foy
	Chicoutimi
	Jonquière
ONTARIO	Toronto
	North York
	East York
	Scarborough
	Mississauga
	Hamilton
	Etobicoke
	Burlington
	Markham
	Thunder Bay
	Sudbury
	Oakville
	Sault Ste. Marie
	Vaughan
	Peterborough
	Kingston
	North Bay
MANITOBA	Winnipeg
SASKATCHEWAN	Saskatoon
	Regina
ALBERTA	Calgary
	Edmonton
	Lethbridge
	Red Deer
BRITISH COLUMBIA	Vancouver
	Kelowna
	Langley

* For communities under 50,000 Imperial will be notifying the affected dealers within two weeks of publication of the notice of application.

Backgrounder

Consumer and Corporate Affairs Canada
Consommation et Corporations Canada

MERGER ENFORCEMENT GUIDELINES ISSUED BY THE BUREAU OF COMPETITION POLICY*

Introduction

To resolve an anticompetitive merger before enactment of the *Competition Act* in 1986, the Director of Investigation and Research was required to refer the merger to the Attorney General of Canada for criminal prosecution. However, the standards required by criminal legislation are not generally appropriate to the forward-looking analysis required in merger review. To resolve this, the *Competition Act* made mergers a civil reviewable matter (i.e. non-criminal).

The Act applies to all mergers in Canada. Parties to very large transactions are obliged by the statute to pre-notify the Bureau prior to completing their merger in order to allow enough time to begin a preliminary examination. The vast majority of mergers occurring in Canada do not pose any competition concerns.

In the relatively small number of cases where a merger is found to be likely to "prevent or lessen competition substantially," the Director may apply to the Competition Tribunal for resolution of the merger on either a consent or contested basis. Contested applications are only pursued when negotiations with the parties to the merger do not provide an appropriate resolution of the Director's competition concerns. Remedial orders sought from the Tribunal may involve dissolution of the merger, or divestiture of assets or shares.

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* This backgrounder on the *Merger Enforcement Guidelines* issued by the Bureau of Competition Policy is provided for general information only. Parties to transactions should refer directly to the Guidelines for more detailed information. Guidance on a specific merger may be requested from the Bureau through its program of advisory opinions. The Backgrounder and the *Merger Enforcement Guidelines* are not intended to substitute for the advice of merger counsellors. Final interpretation of the law is the responsibility of the Competition Tribunal and the courts.

Canada

The need for Guidelines became obvious shortly after the *Competition Act* was passed, but before detailed guidelines could be created a number of issues needed to be resolved through experience. Work on the *Merger Enforcement Guidelines* began in late 1989. Considerable consultation has been pursued with legal and business leaders in Canada as well as economists, Canadian and international government officials and others with an interest in the subject.

While the resulting Guidelines are consistent with the approach taken by Canada's major trading partners, they are also "made in Canada" to reflect the unique features of the Canadian economy.

The *Merger Enforcement Guidelines* provide a detailed discussion of the analytical approach taken to merger review in Canada. They do not represent a significant change in enforcement policy.

Overview of the *Merger Enforcement Guidelines*

Under the *Competition Act*, a merger occurs when "control over, or a significant interest in the whole or a part of a business of a competitor, supplier, customer or other person" is acquired. Part 1 of the Guidelines indicates that this results when a company acquires or establishes an ability to materially influence the economic behaviour of a second company, either through share holdings, management contracts, or other contractual arrangements. A direct or indirect holding of less than ten percent voting interest will not generally be considered a significant interest.

Part 2 of the Guidelines describes the circumstances in which the Bureau considers a merger to be likely to prevent or lessen competition substantially. A "market power" test has been adopted. This normally focuses on whether prices in the market are likely to be higher than they would have been without the merger or a part of the merger. A firm may be in a position to raise prices in a market either by raising only its own price, or by acting together with its competitors to raise prices.

Competition is likely to be substantially prevented or lessened whenever a merger enables a material price increase to be imposed in a substantial part of the market for a period of two years or more. Non-price factors, such as service, quality, variety, advertising or innovation will also be considered where they are relevant.

Part 3 of the Guidelines provides a comprehensive presentation of the Bureau's approach to market definition. Relevant markets for merger review are defined to be the smallest group of products and the smallest geographic area in which the sellers, if they acted as a single firm, could profitably impose and sustain a significant and nontransitory price increase. Ordinarily, a five percent price increase is considered to be significant and one year is considered to be nontransitory.

When determining the extent of a market, account is taken of the likely responses of buyers and competing suppliers. A number of factors are considered and generally include price relationships, the ease with which competing sellers can make product available, views of buyers and others in the industry, end use and physical characteristics of the product, the costs to buyers of switching suppliers, transportation costs, local set-up costs for outside suppliers and shipment patterns.

Part 4 of the Guidelines outlines the evaluative criteria which are used to determine the likelihood that a merger may result in a substantial lessening or prevention of competition. The market share of the merged firm and post-merger industry concentration are only two of many factors considered. While these alone cannot indicate whether a merger will likely be anticompetitive, the higher the market share and concentration will be after a merger, the more likely the Director will be concerned about the transaction.

Where the merged firm will have less than 35 percent of the market, the Director will not generally be concerned about the firm raising prices in the market by raising only its own price. Moreover, where the top four firms in the market hold a total share of less than 65 percent, the Director will not generally be concerned about prices being raised in the market by firms acting together. Even if the top four firms have a share of greater than 65 percent but the merged firm will hold less than 10 percent of the market, the Director will not generally be concerned. Market shares above these levels do not automatically mean the Director will be concerned, only that a closer examination of the merger will be made.

The other factors which will be considered when closer examinations are made are outlined in Part 4 of the Guidelines. These factors include: foreign competition; the likelihood that one of the firms involved in the merger will fail or exit the market; the availability of acceptable substitutes for buyers; the barriers facing new competitors who wish to enter the market; the effectiveness of remaining competition; whether the merger removes a vigorous and effective competitor; the extent to which change and innovation in the market will be affected; and any other relevant factor.

The factors of greatest importance are barriers to entry, business failure and the effectiveness of remaining competition. A merger will not be challenged when it can be established that entry by new competitors is likely to occur on a sufficient scale to prevent a substantial lessening of competition from occurring. Likewise, a merger will not be found to be anticompetitive when it involves a failing or exiting firm where it can be established that no competitively preferable buyers exist, the firm would not likely remain in the market and liquidation of the firm would not likely yield a more competitive market. Finally, a merger will not be found to be anticompetitive when the level of effective competition remaining in the market after the merger will not be reduced.

In addition to the above, the *Competition Act* also provides for an exception to otherwise anticompetitive mergers where the merger is likely to bring about gains in efficiency that will be greater than and will offset the effects of any prevention or lessening of competition, and these gains would not likely result if the merger were challenged. Part 5 of the Guidelines is devoted to describing the issues examined under this exception.

Part 6 of the Guidelines briefly summarizes a number of process matters involved in merger review, including timing, confidentiality and information exchanges between the firms involved in the merger, among other matters. With respect to timing, the Bureau of Competition Policy is usually in a position within three weeks of receipt of the necessary information to inform parties whether their transaction raises any concerns. In the relatively few cases where concerns are raised, the Bureau will generally require an additional eight weeks to finalize their assessment. Only in the most complex transactions will further time be required.

Copies of the *Merger Enforcement Guidelines* may be obtained from the:

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